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## **CAP HEALTH CHECK – IMPACT ASSESSMENT NOTE N° 1**

**Subject: Single Payment Scheme**

### **1. BACKGROUND**

The objective of the 2003 CAP reform was to provide a direct payment system that allows farmers to be market oriented, is as simple as possible from an administrative point of view, and is compatible with WTO requirements for Green Box payments. This was achieved with the introduction of the Single Payment Scheme (SPS), which rendered decoupled farm support the central element of the 2003 CAP reform.

In implementing the SPS, MS could opt for a historic model (payment entitlements based on individual historic reference amounts per farmer), a regional model (flat rate payment entitlements based on amounts received by farmers in a region in the reference period) or a hybrid model (mix of the two approaches, either in a static or in a dynamic fashion). The EU-12 could choose to apply the Single Area Payment Scheme (SAPS), a simplified area payment system, for a transitory period until end 2010 (2011 for Bulgaria and Romania).<sup>1</sup>

In order to receive payments, farmers have to activate their SPS entitlements by matching them with a corresponding number of eligible hectares. In the historic model the number of payment entitlements corresponds to the number of hectares that generated support payments in the reference period; thus eligible land not used to activate entitlements remains as "naked land". On the other hand, in the regional implementation the number of payment entitlements broadly matches the number of eligible hectares.

This significant shift in farm support was facilitated by the flexibility that MS had in their choice. However, whatever the choice of model, both historic and regional approaches to decoupling are similar in two fundamental aspects. Both models do not

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<sup>1</sup> Denmark, Germany, Luxembourg, Finland, Sweden, UK - England and UK - Northern Ireland apply the hybrid model (some static, some dynamic). Belgium, Ireland, Greece, Spain, France, Italy, the Netherlands, Austria, UK – Scotland and UK – Wales apply historic the model. Malta and Slovenia apply the regional model. The rest of the EU-12 apply the SAPS. The single area payment of the SAPS is a flat rate payment per hectare at MS level. It is calculated by dividing the annual national financial envelope of the MS by the agricultural area under SAPS in a given year.

guide production choices, but allow farmers to be market oriented by reacting to market signals and price developments. Both models have a fixed reference in payments and in the area to which these payments correspond.

But the two fundamental choices in implementing the SPS, and their variants, also have a significant difference with respect to the distribution of support, whether this is fixed in one shot (static) or gradually (dynamic).

- The first approach (historic model) respects the previous level of support that farmers received, and leaves redistribution issues to be dealt with through modulation. As a result this SPS model uses the *farm as the fixed reference* for the allocation of payment rights (entitlements).
- The second approach (regional model), driven mainly by equity arguments since redistribution was significantly scaled down because of the limited extent of modulation, addresses issues of redistribution of support through the SPS. As a result, this SPS model uses the *area as the fixed reference* for the allocation of entitlements.

In practice, MS choices led to an almost even split, in budgetary terms, between historically-based and regionally-based support. Both approaches achieve the objective of WTO compatibility by introducing fixed references for the payments farmers receive. And although the initial implementation of the regional model proved to be more complex, once in place both models are similar in their implementation rules.

To provide MS with additional flexibility to target specific needs, Article 69 of Regulation (EC) 1782/2003 authorises them to take up to 10% of the component of the national ceilings of each sector to allocate additional payments to the farmers engaged in important types of agriculture for the protection or improvement of the environment or for improving the quality and marketing of agricultural products. Payments are made to farmers within the sector(s) affected by this retention. At its origin, Article 69 was intended to provide some limited flexibility to MS to deal with unintended consequences of decoupling.

## **2. PROBLEM DEFINITION**

### **SPS model**

As Member States prepare themselves for future adjustments in the CAP, they should be allowed to adjust their SPS model based on the experience gained so far from its implementation across the EU. However, in the current legislation there is no provision that would allow MS to make such changes.

The possibility to introduce adjustments to the SPS model is particularly relevant since the question of how equitably support is distributed among farmers, persists as an important issue, especially under the historic model.

The historic model allowed farmers to be market oriented while keeping their past support level while the regional model redistributed support to farmers in a way that the support per hectare is similar within regions. The historic model can, thus, be regarded as being less equitable since it gives aid to individual farmers based on their past support levels, which reflect the previous structure of production and of agricultural support. As

the historic reference period for payments becomes more distant, these individual differences will continue to become harder to justify.

### **Article 69**

Further decoupling and the expiry of the dairy quota could affect the income of certain producers in particular regions. This could also negatively affect the vitality of rural areas where farmers have no viable alternatives and could lead to the discontinuation of certain environmentally beneficial types of farming. Furthermore, the need for additional tools to address risk management has become apparent.

The possibility to give targeted, flexible support under Article 69 has raised interest in the applicability of this article as a means to mitigate such problems. However, in its present form, Article 69 does not appear suitable to address these issues due to the fact that the rule that payments can only be made to farmers in the sectors affected by the retention of funds limits the flexibility of MS in applying Article 69.

## **3. OBJECTIVES**

### **SPS model**

The specific objectives of adjustments to the SPS implementation in terms of the model applied are to give MS the possibility to:

- Adjust their chosen model towards flatter rates of support
- Address concerns about the equity and distribution of payments among farmers
- Continue to ensure high transfer efficiency, market orientation of the farming sector and environmental sustainability of farming through compliance with EU standards
- Limit administrative burdens and simplify the system where possible

### **Article 69**

With respect to the revision of Article 69 the specific objectives are to:

- Provide a flexible instrument to address specific problems stemming from further decoupling and the end of the dairy quota
- Address risk management needs, thus mitigating possible income problems
- Continue environmentally beneficial agricultural production in regions that could be negatively affected
- Contribute to the vitality of rural areas in certain where farmers may not have viable alternatives
- Ensure that supporting measures remain in conformity with WTO commitments

## **4. POLICY OPTIONS – SPS MODEL**

There are four options for allowing MS to adjust their chosen SPS model.

#### **4.1. Status Quo**

No review possibility for MS; both historic and regional/hybrid models continue as present.

#### **4.2. Option 1: EU-wide flat rate per eligible hectare**

Farmers in all EU Member States receive the same flat rate payment entitlement per eligible hectare.

#### **4.3. Option 2: SAPS for all MS**

The Single Area Payment Scheme (SAPS) becomes the model for all EU MS.

#### **4.4. Option 3: Regional flat rates per eligible hectare**

Member States move towards regional flat rate entitlements per eligible hectare<sup>2</sup>.

#### **4.5. Option 4: Regional flat rates per entitlement**

Member States move towards regional flat rate entitlements based on current entitlements. This implies adjusting entitlement values without changing the number of entitlements.

### **5. IMPACT ANALYSIS – SPS**

In the public perception, the biggest difference between the historic and the regional/hybrid SPS models lies in their distribution impact. Land value considerations are largely limited to the research community. Therefore, the starting point for understanding the impacts of a move towards a flat rate is to consider the current distribution of direct payments in the EU, and assess the impact of various SPS options on this distribution (see section social impacts). However, the effects on land values and transfer efficiency are also examined (section economic impacts) and the environmental and administrative consequences are discussed (environmental impacts, administrative impacts/simplification).

#### **5.1. Economic impact**

##### *5.1.1. Status Quo*

Due to the fact that entitlements have to be activated with eligible hectares, part of direct support is captured ("capitalised") in the value of land. Capitalisation of support in land values should be the higher, the less "naked land" (eligible land not currently used to activate entitlements) exists because this gives farmers less flexibility for the activation of their entitlements and strengthens the position of landowners.

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<sup>2</sup> Regional flat rates would be created on the basis of the decoupled payments under the SPS only. The FADN simulations done for this note are based on the current decisions of MS with respect to the decoupling of payments. The simulation for the EU-27 flat rate assumes full decoupling (see also Annex 2).

Capitalisation of support in land values affects the transfer efficiency of support as some of it may flow to (possibly non-farming) landowners instead of to the intended beneficiaries, the active farmers. However, the scale of this effect depends crucially on the land ownership structure which differs substantially between the EU MS (see Annex 1, figure 2)

As pointed out above in the background section, the two basic SPS models, historic and regional, lead to differences in the amount of "naked land" (see Annex 1, figure 1). Since there tends to be more "naked land" under the historic model, the degree of capitalisation of support in land prices should be lower, and hence the transfer efficiency better, for this SPS implementation than for the regional model, where the amount of "naked land" is very limited<sup>3</sup>.

The redistribution of support among farmers in the regional model is likely to have had an effect on asset prices, which may induce a structural response of farms. However, by setting flat rates at a regional scale, payments could be adjusted to the conditions of different regions, taking into account differing natural conditions and land characteristics.

#### *5.1.2. Option 1: EU-wide flat rate per eligible hectare*

An EU-wide flat rate per eligible hectare would lead to a very significant redistribution of support across EU MS (figure 4). Due to the capitalisation of support in land values this would have a strong effect on land values, leading to substantial increases in some MS and regions and parallel substantial decreases in others.

In addition to this, the transfer efficiency of support would be reduced since a flat rate per eligible hectare would lead to a decrease in the amount of "naked land" and therefore to a higher degree of capitalisation of support in land values.

#### *5.1.3. Option 2: SAPS for all MS*

The Single Area Payment Scheme was introduced in the new MS before the introduction of the SPS to facilitate their adjustment to the EU because of their specific agricultural situation.<sup>4</sup> As a transitional system, SAPS was designed to assist the integration of new MS in a smooth manner, given the very significant differences between the level of their general and rural economies and those in the EU-15.

As the deadline for the expiration of SAPS approaches, and new MS consider their integration into the SPS, the possibility of extending this deadline to the end of the present financial framework if they so wish seems

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<sup>3</sup> The ongoing study "Study on the Functioning of Land Markets in the EU Member States under the Influence of Measures applied under the Common Agricultural Policy" may shed some light on the issue of agricultural support and its interaction with land values at a later stage.

<sup>4</sup> This situation was characterised by very different and much lower (where relevant) levels of support, the absence of previous payment and area references and the consequent absence of control systems.

a natural choice if, at the same time, EU-15 MS are allowed to review their SPS implementation and opt to move towards a more flat rate model.

As a transitional scheme, SPS clearly performed its intended role. Yet at times SPS has been considered as a system which should be applied to all MS, i.e. an inverse move from SPS to SAPS is considered as desirable.

However, it should be borne in mind with such suggestions that SAPS is a fundamentally different system from the SPS. Analysis needs to focus on the main difference between SPS and SAPS – the fixed entitlement reference of the former and the varying area reference of the latter.

The SAPS is a flat rate area payment per hectare at MS level, calculated by dividing the annual national financial envelope of the MS by the agricultural area under SAPS in a given year. While this is acceptable as a transitional scheme, as a permanent scheme it would contradict the philosophy of decoupled support because it would not be a system based on fixed entitlement references.

In terms of its impact on land values<sup>5</sup> and transfer efficiency, a SAPS for all MS would lead to substantial impacts on land prices within MS (due to redistribution among farmers) and higher capitalisation of support, resulting in decreased transfer efficiency. Due to the fact that the SAPS is an area payment that does not separate payment entitlements from land, it leads to a particularly high degree of capitalisation of support in land values.

#### *5.1.4. Option 3: Regional flat rates per eligible hectare*

Regional flat rates per eligible hectare would have an impact on land values due to redistribution but this impact could be mitigated by taking into account land characteristics when harmonising payments in a regional context.

However, by decreasing the share of "naked land", regional flat rates per eligible hectare would still increase the degree of capitalisation and decrease transfer efficiency.

#### *5.1.5. Option 4: Regional flat rates per entitlement*

Like in option 3, the impact on land values of regional flat rates per entitlement would be mitigated by the possibility to design appropriate regions.

Furthermore, under this option, the degree of capitalisation of support in land values remains unchanged as compared to the status quo since the amount of "naked land" would remain the same. Transfer efficiency would thus not be negatively affected.

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<sup>5</sup> The ongoing study "Review of Transitional Restrictions Maintained by New Member States with Regard to the Acquisition of Agricultural Real Estate" will provide some information on land price developments in the new MS.

## 5.2. Social impact

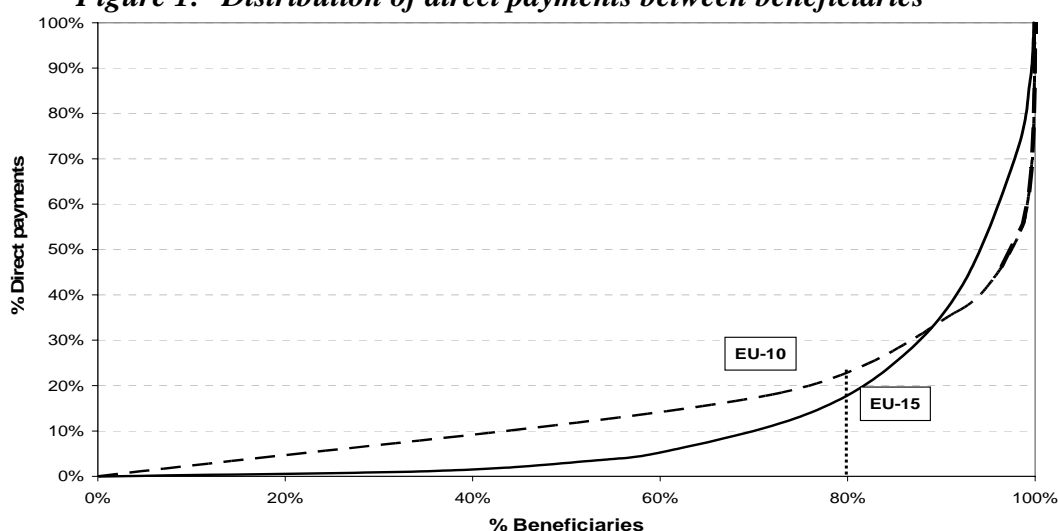
### 5.2.1. Status quo

Historic and regional model of the SPS generate differences with respect to their equity/redistribution impact. While the historic model did not redistribute support between farmers, but gives aid to individual farmers based on their past support levels, the regional model redistributed payments in a way that the support per hectare is similar.

As can be expected, the range of direct payments per hectare tends to be wider in the MS applying the historic SPS model than in those applying hybrid/regional models (see Annex 1 Figure 3).

Figure 1 demonstrates the often mentioned "80-20" figure – the fact that in the EU-15 80% of beneficiaries receive a bit less than 20% of payments (in the EU-10, the corresponding figure is slightly above 20%). Differences in payment levels reflect the different production structure in EU agriculture and the level of previous support that generated such payments.

**Figure 1: Distribution of direct payments between beneficiaries**



Source: CATS data (2006 budget year)

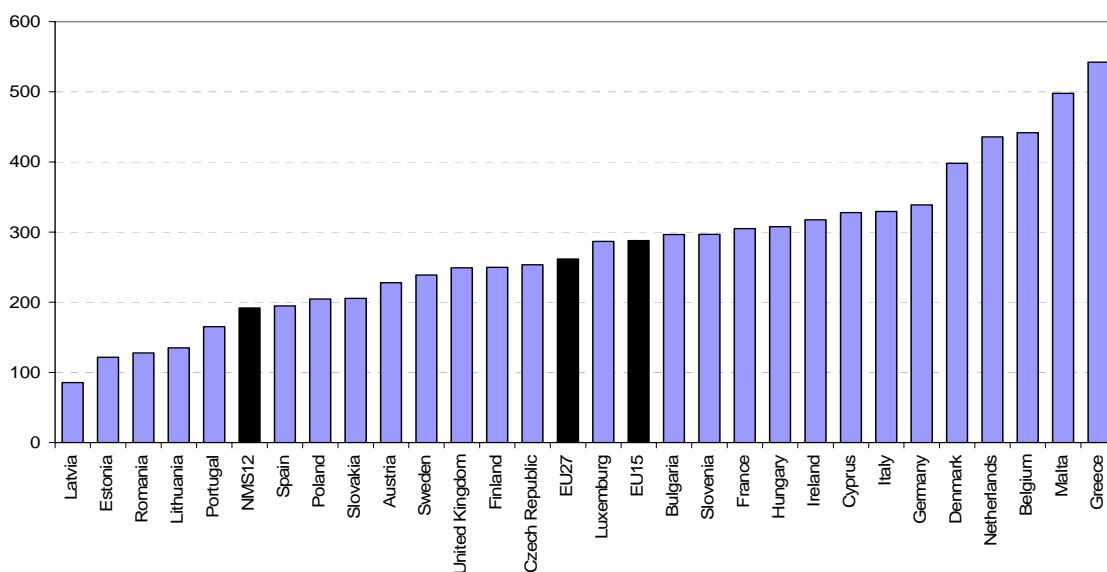
The differences between MS result in a wide range of distribution of direct payments within the EU (Figures 2 and 3<sup>6</sup>). To facilitate comparison, these payments are calculated based on their expected level after all MS fully implement CAP reforms and new MS fully integrate into the CAP.

Note that these averages differ widely among MS whether the variable used as reference is the payment per area (hectare) or whether the payment is calculated per beneficiary.

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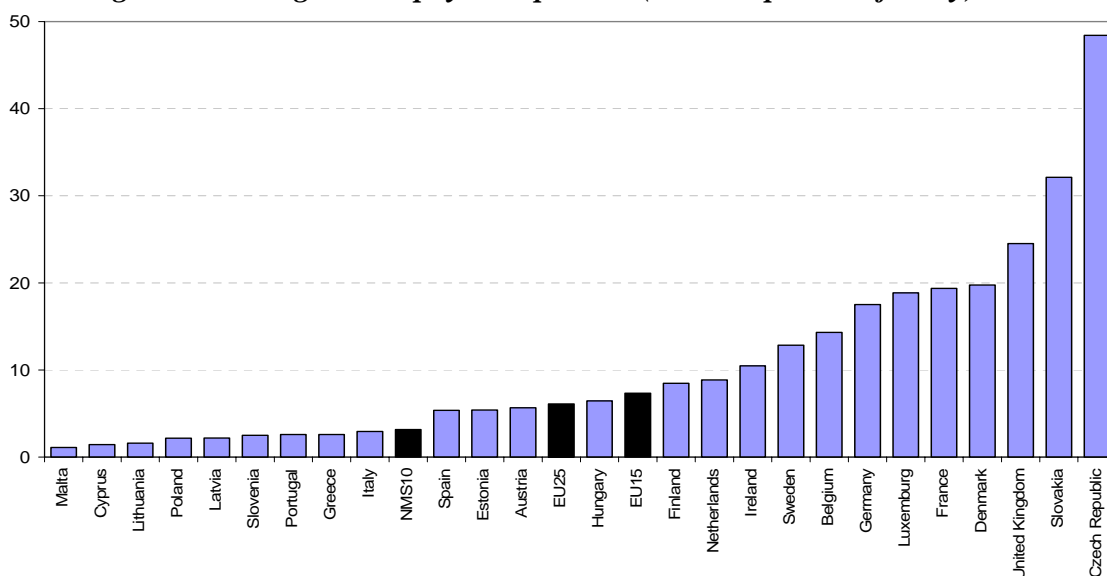
<sup>6</sup> The calculations in Figures 2 and 3 reflect rough approximations arrived at by dividing the national ceilings (for 2016 and after, i.e. after full phasing-in of the EU-12) by the Utilised Agricultural Area (UAA) and the number of beneficiaries, respectively. Note that these calculations have a different source than the FADN simulations also referred to in this paper (see Annex 2 for details on FADN simulations).

**Figure 2: Average direct payment per MS (in € per hectare)**



Source: DG AGRI calculations on the basis of Eurostat (UAA), Reg. 1782/2003 (national ceilings)

**Figure 3: Average direct payment per MS (in 000 € per beneficiary)**



Source: DG AGRI calculations on the basis of CATS (beneficiaries), Reg. 1782/2003 (national ceilings)

These graphs are also indicative of the complexities in farm production structures among EU MS. The MS with the highest per hectare payment figures among those MS with the lowest rate of payment per beneficiary; on the other hand, the MS with the highest payment per beneficiary is around the EU average when area is the reference variable<sup>7</sup>.

<sup>7</sup> The caveat to keep in mind with these graphs (as with any aggregate figure) is that they reflect existing equity problems but may lump them with perceived equity problems. One example of the gap between perceived and real equity problems is the suggestion by one stakeholder in the public consultation Seminar of December 6, 2007 that a "fair" distribution of payments would be "20-20". But the ways to arrive at such a distribution are entirely unrealistic: either by having every farmer with



Experience with the regional model shows that, in most cases, the number of beneficiaries increased substantially with respect to previous claims during the first year of application. This is due to the fact that in the regional model everyone who declared eligible hectares in the first year of implementation received entitlements while in the historic model, only those who received support in the reference period received entitlements. As a result, the regional model led to a redistribution of payments, not only between farmers but also from "old" beneficiaries to newcomers.

Due to the higher degree of capitalisation of support in the regional model, it is to be expected that more support ends up with (possibly non-farming) landowners that under the historic model<sup>8</sup>.

### 5.2.2. *Option 1: EU-wide flat rate per eligible hectare*

EU-wide flat rates per eligible hectare mean that payment levels per area will be equal in all EU MS. This may be perceived as more equitable. However, it also needs to be taken into account that in some of the biggest beneficiaries from such a move (among them new MS), this option reverses the very logic of the Accession Treaty, which was to take into account the potential impact of the level of support in the rest of the economy in order to avoid huge distortions within the population.

Furthermore, the present level of support within MS is the result of a very delicate balance of budgetary transfers, including fixed national SPS ceilings for payments within the framework of the existing financial perspectives. An EU-wide flat rate would thus violate the present financial framework. The redistributive impact among MS of a move towards an EU-wide flat rate per hectare would be substantial. Figure 4 demonstrates this by indicating the % change in the overall amounts each MS would receive<sup>9</sup>.

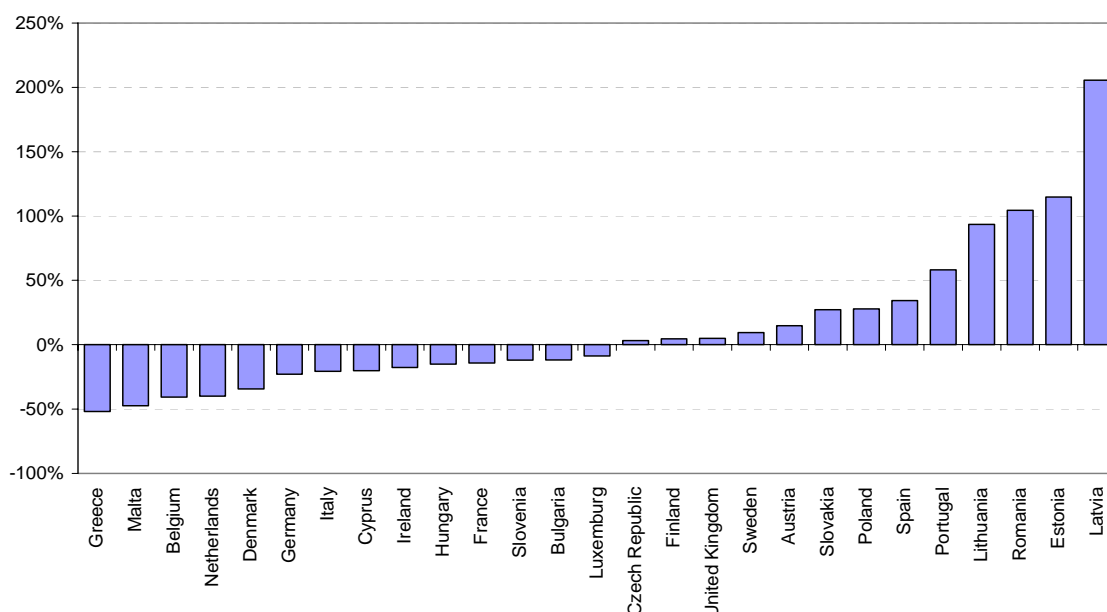
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the same aid regardless of his/her farm area, or by somehow forcing every farmer to adjust their area in the way that they receive the same payments.

<sup>8</sup> Results of the GENEDEC project indicate that the effect of direct payments on farm income is stronger in the historic model than in the regional model. This is due to the fact that the stronger capitalisation in the regional model directs a larger share of payments from active farmers to landowners when land is rented. See GENEDEC project at <http://www.grignon.inra.fr/economie-publique/genedec>, especially: F. Arfini, W. Kleinhanss, B. Kuepker, P.A. Jayet (2007): Insights from GENEDEC - Part: Incomes, Productions, Prices (PPT presentation)

<sup>9</sup> The graph compares the national ceilings currently established for MS in Reg. 1782/2003 with the amounts they would receive if they got the EU average payment per hectare (as shown in figure 2).

**Figure 4: Redistribution between MS with an EU-wide flat rate**



Source: DG AGRI calculations on the basis of Eurostat (UAA), Reg. 1782/2003 (national ceilings)

It is important to underline that equal support rate per hectare in the EU actually change little in the "uneven" distribution of support between farms at EU level<sup>10</sup> (see Annex 3 for details), although the change in the level of payments per farm is considerable in some cases. This is due to the fact that flat rates per hectare link the distribution of payments to the distribution of land. But land itself is not evenly distributed between farms and tends to be as skewed as the distribution of production in the EU (which is the historic reference for payments)<sup>11</sup>.

Overall changes to the distribution of direct payments among farms with the introduction of an EU-wide flat rate are small but there are substantial variations between the MS. In some MS, flat rates do lead to a more "even" distribution of direct payments among farms but in others the opposite is the case (see figure 7 and also Annex 3 for details on results of different measures of range and concentration of direct payments).

Despite the low impact on overall distribution, one effect of EU wide flat rates is a reallocation of DP between economic size classes of farms. DP/ha and income/AWU are decreasing for the largest farms and increasing in the lower size classes (Figure 5).

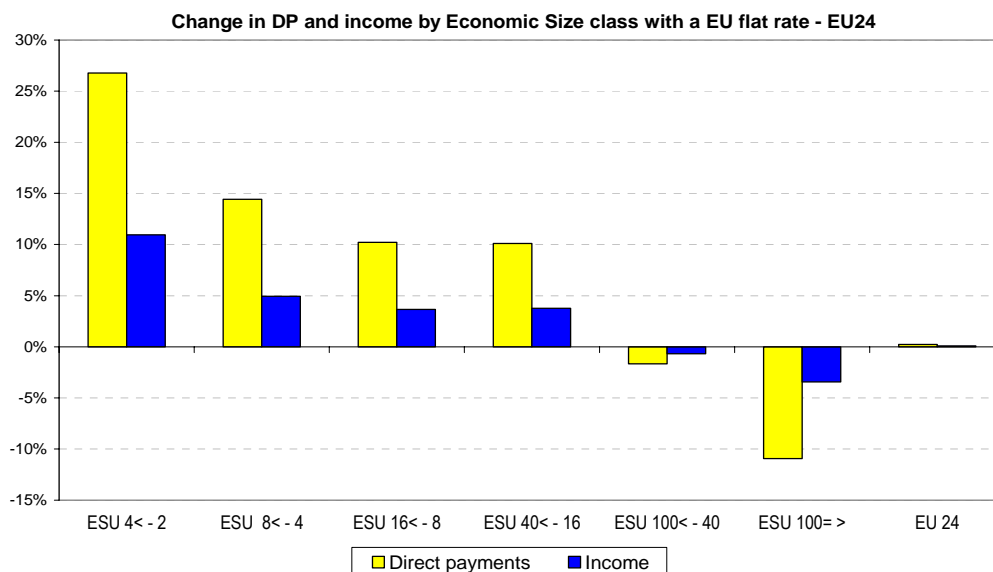
The EU flat rate would also lead to an increase in the average direct payments (+19%) and income (+8%) in least favoured areas (LFA). However, in most MS with a general decrease of direct payments because of

<sup>10</sup> Results are based on simulations based on FADN data, see Annex 2 for methodology.

<sup>11</sup> In the case of an EU-wide flat rate payment based on all Utilised Agricultural Area (UAA), the distribution of direct payments would correspond to the distribution of area in the EU-27. In 2005, 20% of the farmers with the largest area used 87% of UAA in the EU-27 (Annex 1 Figure 4).

the redistribution implied by the move towards a flat rate, direct payments and income are decreasing in LFA too.

**Figure 5: Effect of an EU-wide flat rate on economic size of farm classes**



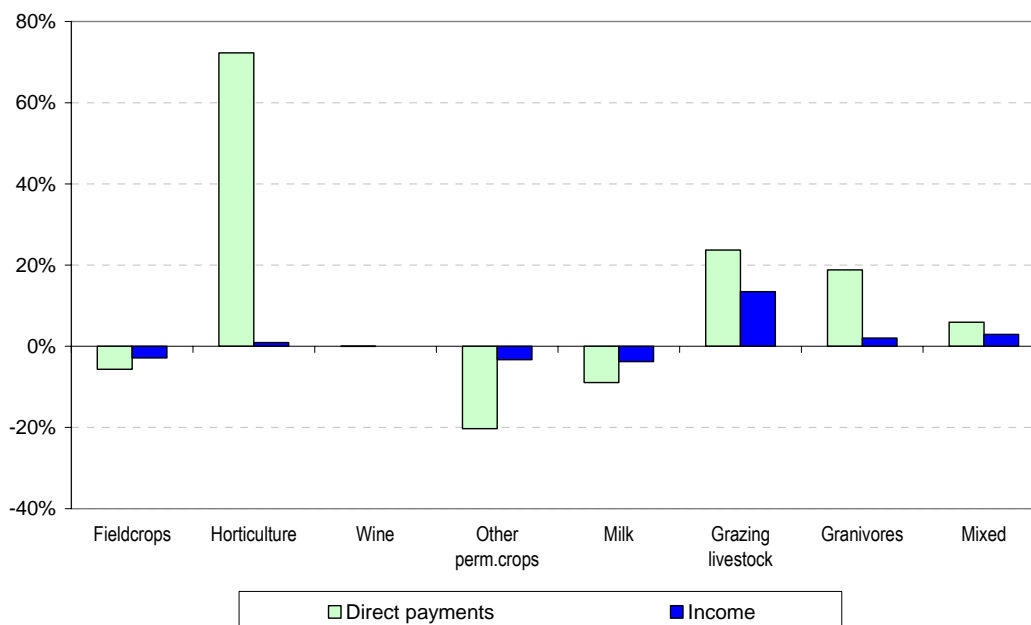
Source: DG AGRI EU FADN simulation (size classes based on ESU (European Size Units))

Another important aspect of an EU-wide flat rate would be the extremely different impact on different farm types (Figure 6). Analysis on income and direct payments received by type of farming shows that milk specialists, field crops and other permanent crop specialists are negatively affected, whereas impacts on grazing livestock and granivore specialists and horticultural farms<sup>12</sup> would be positive. Impacts on the different types of farming differ substantially between MS. Results are summarised in Annex 1 Figure 6.<sup>13</sup>

<sup>12</sup> Note that, while the impact on horticulture seems large when the change in direct payments per farm is regarded, the average area in horticulture is very small. Therefore the impact on income is small.

<sup>13</sup> The effect concerns both MS applying the historic and MS applying the hybrid model of the SPS since the bulk of the envelope of payments distributed on a historic basis in hybrid models tends to come from beef, sheep and dairy.

**Figure 6: Impact of EU flat rate on different types of farming**



Source: DG AGRI EU FADN simulation

The EU-wide flat rate per eligible hectare would probably increase the number of beneficiaries and lead to some redistribution from "old" beneficiaries to newcomers.

Due to the higher degree of capitalisation of support with a flat rate per eligible hectare, it is to be expected that more support benefits landowners that under the historic model.

### 5.2.3. Option 2: SAPS for all MS

SAPS for all MS would lead to equal payment levels per hectare for all farmers in a MS. Again, this could be considered as a more equitable distribution of support.

However, as for its distributional impacts, a SAPS for all MS is the same as an area payment per eligible hectare per MS. This means that, like an EU-wide flat rate per eligible hectare, the current skewed distribution of support based on past support levels would be replaced with the skewed distribution based on agricultural land.

The tendency of the results in terms of the impacts on different farm types and farm sizes, as well as for the distribution among old and new beneficiaries and farmers and landowners, should be similar to those shown

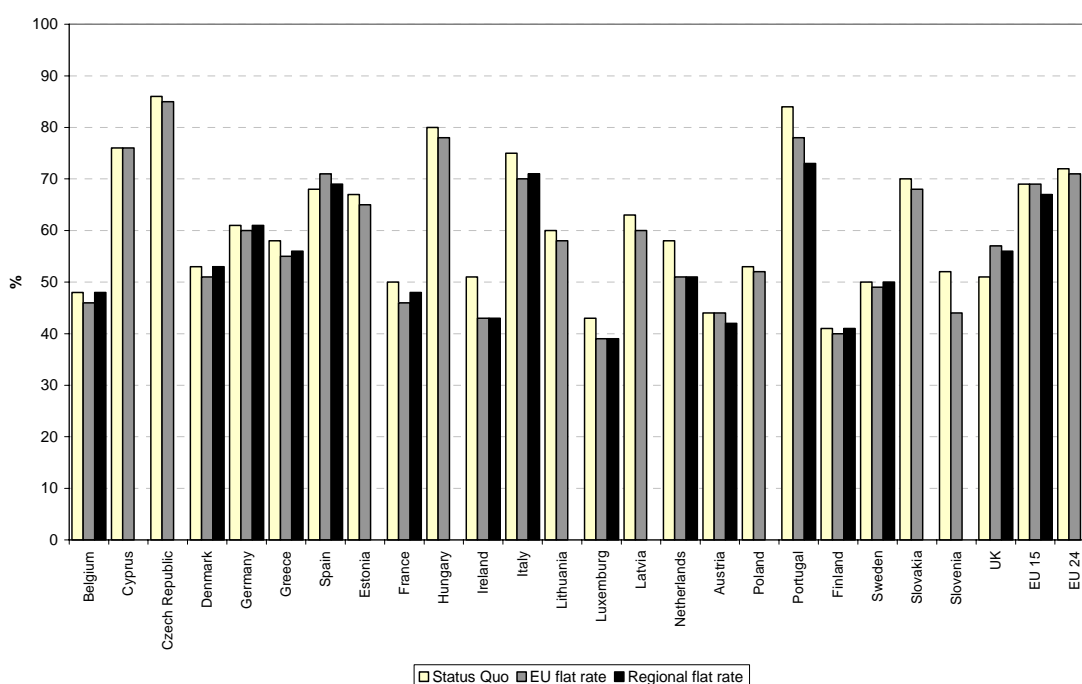
for option 1 and 3, generally lying between those of EU-wide flat rates and regional flat rates per eligible hectare<sup>14</sup>.

#### 5.2.4. Option 3: Regional flat rates per eligible hectare

Regional flat rates per eligible hectare may be perceived as more equitable than a regional model as they provide for the same per-hectare support for all farmers within a region.

However, like the EU-wide flat rate, a regional flat rate per eligible hectare does not change much with respect to the distribution of support between farms in the EU. Figure 7 shows that the share of direct payments received by the 20% beneficiaries with the highest direct payments is unchanged in the EU-15 with a regional flat rate. But there are variations between the MS - although less pronounced than with the EU-wide flat rate<sup>15</sup> - and in a number of MS there are improvements towards a more "even" or "uniform" distribution, which is also indicated by the results of different measures of range and concentration of direct payments (Annex 3).

**Figure 7: Share of direct payments received by 20% of beneficiaries**



Source: DG AGRI EU FADN simulation<sup>16</sup>

<sup>14</sup> The SAPS for all MS option was not simulated with FADN data. However, since both an EU-wide and a regional flat rate per eligible hectare were simulated the effects can easily be deduced from these results.

<sup>15</sup> However, it has to be noted that this is also due to the fact that only the EU-15 were regarded for this kind of flat rate.

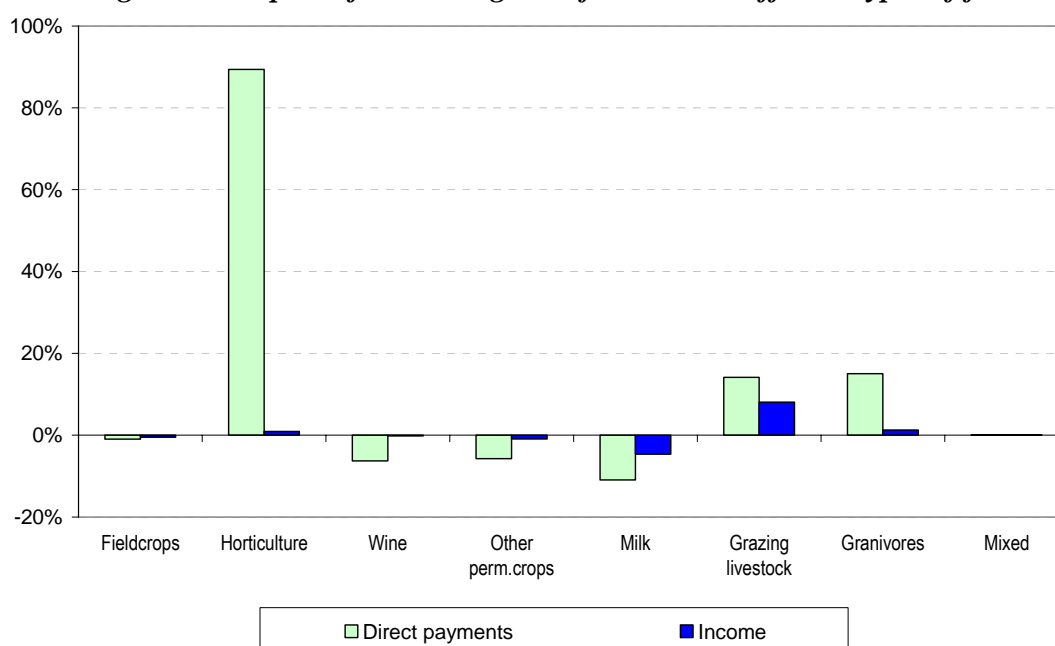
<sup>16</sup> The slight difference for the EU-15 distribution as compared to figure 1 is due to different data sources: CATS for figure 1, FADN for figure 7.

The regional flat rate per hectare, like the EU-flat rate (though to a lower extent), leads to a reallocation of direct support from larger to smaller economic size classes of farms.

It also benefits least favoured areas (LFA), increasing average direct payments by 9% and income by 3% in LFA while leading to a decrease in direct payments of 7% in non-LFA.

The variation in the impact on different farm types is also present here, but again less pronounced than with the EU-flat rate (Figure 8). Milk specialists and other permanent crop specialists are negatively affected<sup>17</sup>, grazing livestock and granivore specialists and horticulture are positively affected<sup>18</sup>. Impacts among MS differ (Annex 1 Figure 5).

**Figure 8: Impact of an EU regional flat rate on different types of farming**



Source: DG AGRI EU FADN simulation

The regional flat rate per eligible hectare would probably increase the number of beneficiaries and redistribute funds from "old" beneficiaries to newcomers.

Due to the higher degree of capitalisation of support with a flat rate per eligible hectare, it is to be expected that more support benefits landowners

<sup>17</sup> In the case of wine, as a reminder: whatever the model (historic, hybrid or regional), vineyards were not eligible to direct payments in the reference period used for these calculations, and had no direct payments except for the area to produce dried raisins (important production in Greece). Moreover it is not rare that olive trees are associated to wine production. Hence, farms producing exclusively wine are not affected by the negative impact on direct payment shown in the graph. Due to the reference period used, these calculations do not take into account the consequences of the Council agreement on the wine reform achieved on 19/12/2007 which will allow eligibility of all vines from 01/01/2009 and allow grape wine producers to be granted entitlements.

<sup>18</sup> See footnote 11.

that under the historic model.

#### 5.2.5. *Option 4: Regional flat rates per entitlement*

It is possible to mitigate the undesired consequences of a redistribution of support favouring landowners and leading to new beneficiaries while still keeping the desired impact of more even payments among active farmers with a move towards a flat rate that is based on the existing entitlements. In this option, the value of the regional flat rate per entitlement is derived by dividing the total value of payment entitlements within a region by the number of existing entitlements.

With respect to overall redistributive effects, the effects of a regional flat rate for entitlements should be similar to that of regional flat rates per eligible hectare.<sup>19</sup> However, there are some notable differences.

The flat rate for entitlements would not change the degree of capitalisation of support in land values as compared to the Status Quo since the amount of "naked land" would remain the same. Therefore, the share of support between landowners and farmers would not be affected and the transfer efficiency should not be reduced. However, the existing capitalisation of support would still mean that the redistribution of support would lead to adjustments to farmers' land values under this option.

Additionally, the regional flat rate for existing entitlements would not lead to new beneficiaries in the SPS system since only those already holding entitlements would be affected. There would consequently be no redistribution from "old" to new beneficiaries.

### 5.3. **Environmental impacts**

#### 5.3.1. *Status Quo*

Environmental impacts of SPS implementation relate to the amount of land that is under cross compliance<sup>20</sup> and to potential impacts that changes in the level of farms' payments may have on their production practices.

Farmers receiving direct payments and certain agri-environmental payments face the reduction or cancellation of their payments if they do not respect cross compliance (SMRs and GAEC). Historic and regional/hybrid implementation do not have different impacts in this respect since cross compliance is applied as a "whole farm approach". This means that cross compliance has to be respected on the whole eligible area of the farm including "naked land" not used to activate entitlements.

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<sup>19</sup> Due to technical complexities the specific analysis was not possible on the basis of FADN.

<sup>20</sup> See "Evaluation of the application of cross compliance as foreseen under regulation 1782/2003" and "Study to assess the administrative burden on farms arising from the CAP" for more information on the Status Quo of the cross compliance system.

### *5.3.2. Option 1: EU-wide flat rate per eligible hectare*

Due to the whole farm approach of cross compliance the move to EU-wide flat rates per eligible hectare would not change the amount of land under cross compliance for farms that received payments before. However, new beneficiaries might enter the system with a flat rate per hectare, which could bring some additional land into the cross compliance system.

Due to the redistribution between farm types, flat rates may benefit farmers with more extensive farming systems. However, since support is decoupled from production, this would not necessarily entail a change in the use of such farming systems and, hence, in the resulting possible environmental benefits.

### *5.3.3. Option 2: SAPS for all MS*

A SAPS system for all MS (assuming that full cross compliance is required<sup>21</sup>) should have the same effect as option 1 with respect to the amount of land under cross compliance as SAPS would cover the whole eligible area of a MS.

However, a move to SAPS would encourage farmers to extend their agricultural area in order to maximise their direct payments and would therefore risk putting an artificial pressure on land not currently used for agriculture but that may have a high environmental value.

### *5.3.4. Option 3: Regional flat rates per eligible hectare*

The effect of this option on the amount of land under cross compliance and on farming systems should be the same as for option 1.

### *5.3.5. Option 4: Regional flat rates per entitlement*

There should be no change in the amount of land under cross compliance for this option. The effect on farming systems should be the same as under option 1.

## **5.4. Administrative impacts/simplification**

### *5.4.1. Status Quo*

As explained above, the regional SPS model led to the appearance of a number of new beneficiaries. This makes it necessary to process more applications for direct support than under the historic system with correspondingly higher administrative costs.

Apart from this, the models should be similar in their administrative burden and both can be combined with further simplifications to the system.

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<sup>21</sup> Currently, the MS applying the SAPS have to respect only the GAEC.



Such simplifications could be introduced where, due to the fact that more sectors have entered into the SPS in the meantime and experience has been gained with the implementation of the system, current provisions seem unnecessarily rigid and complex and could be modified in a way that is neutral to the SPS model applied and does not negatively affect the operation of the system. Simplifications of this kind could include the reduction of the number of different types of entitlements, lifting restrictions on the transfer of entitlements received from the national reserve, lifting restrictions on the transfer of entitlements without land, and others.

#### *5.4.2. Option 1: EU-wide flat rate per eligible hectare*

An EU-wide flat rate per eligible area would involve an initial change in the number and value of entitlements. Farmers would have to declare all their eligible hectares in the first year of application of the new flat rate system. There would be new beneficiaries as well as a redistribution of funds between MS. This would involve significant additional administrative costs.

This option could be combined with further simplifications to the SPS system as described under the Status Quo.

#### *5.4.3. Option 2: SAPS for all MS*

SAPS for all EU MS would require a fundamental change of system in the MS currently applying the SPS causing administrative costs, including those for new beneficiaries to the system.

On the other hand, the MS currently applying the SAPS would not face the costs of a system change to the SPS. The same effect of avoiding costs for a change in the system for the MS applying SAPS at the current stage could be achieved by prolonging the transitory period during which the EU-12 may apply the SAPS until the end of the current financial period (2013).

#### *5.4.4. Option 3: Regional flat rates per eligible hectare*

Administrative costs would be caused by the need to recalculate number and value of entitlements and due to new beneficiaries entering the system.

This option could be combined with further simplifications to the SPS system as described under the Status Quo.

#### *5.4.5. Option 4: Regional flat rates per entitlement*

Administrative costs of a move towards regional flat rates per entitlement would probably be less pronounced than for a move to regional flat rates per eligible hectare. This is due to the fact that only the value, but not the number of entitlements and their distribution, would change (i.e. no new beneficiaries).

This option could be combined with further simplifications to the SPS system as described under the Status Quo.

## **6. POLICY OPTIONS – ARTICLE 69**

The options for a revision of Article 69 that have been analysed are the following.

### **6.1. Status Quo**

No change to the current content of Article 69.

### **6.2. Option 1: Targeted revision**

The sector-specific rule by which retention and payments have to be made in the same sector would be removed. MS would be allowed to use up to x% of their national ceiling to grant targeted support to farmers in specific sectors (such as dairy, beef, sheep, goat meat and rice) and certain regions and in relation to risk management (in addition to the current use of Article 69). The share of support going to measures that do not with certainty meet the conditions of the Green Box would be limited.

### **6.3. Option 2: Extended revision**

Same as option 1 except that there would be no limitation on the share of support going to non-Green Box measures.

## **7. IMPACT ANALYSIS – ARTICLE 69**

### **7.1. Economic impacts**

#### *7.1.1. Option 0: Status Quo*

No change to the current Article 69 implies that the flexibility for some MS to react to potential problems in the milk sector and other sectors due to the end of the quota and further decoupling, as well as to risk management issues, would be very limited<sup>22</sup>. This would be the case because the requirement that the 10% of SPS support that has to be retained and used within the same sector could severely constrain some MS, e.g. those with more mountainous or fragile dairy regions than others.

#### *7.1.2. Option 1: Targeted revision*

The targeted revision would give MS increased means to tackle possible problems in the milk sector and other sectors arising due to the end of the quota, further decoupling or the need for additional risk management tools. It would not mean a major revision of the current article 69 but would imply some risk of further re-coupling (however within clear limits).

To take the example of the dairy sector, such a revision could address problems in two ways – either through an increase of the decoupled payment

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<sup>22</sup> See also background papers and Impact Assessment report chapters on partial decoupling, dairy and risk and crisis management.

in the regions negatively affected by the abolition of the quota system, or through a coupled payment to the sector in the form of an area or per cow payment linked to production.

The first choice would be fully compatible with the overall WTO orientation of the CAP, but would not necessarily guarantee the continuation of production.

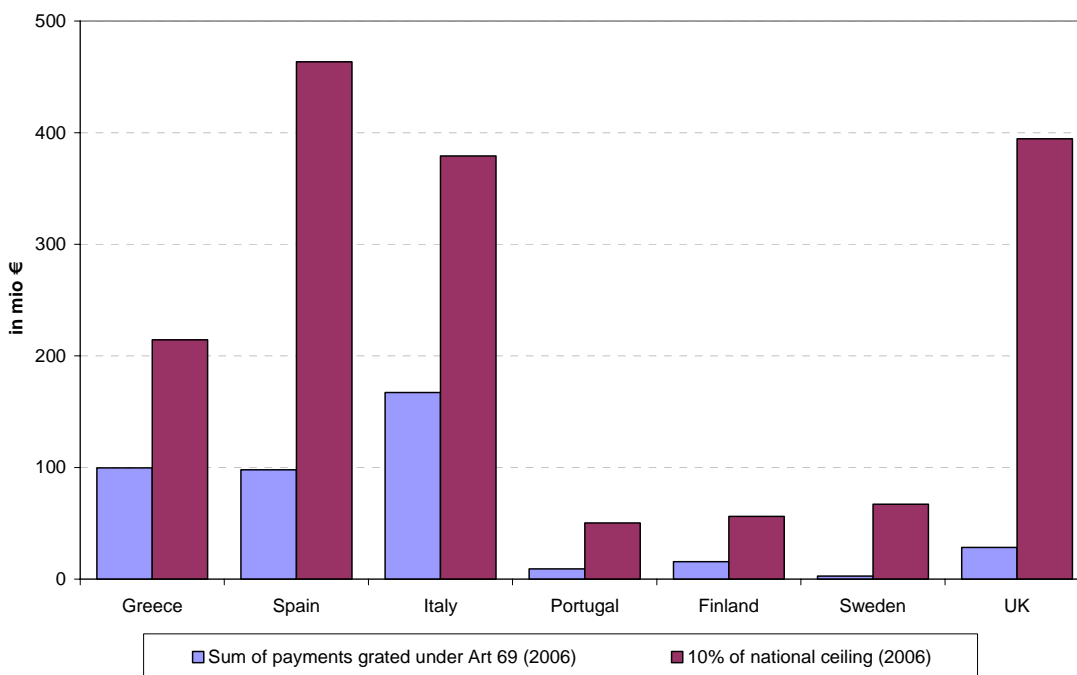
The second choice implies an increase in the level of partially coupled (Blue Box) support. In the case of a DDA agreement, it would thus require a parallel reduction in other partially coupled support (e.g. in arable crops) to allow the EU to remain within its expected margins of Blue Box support in the future. However, an appropriate restriction on the share of coupled measures of support would resolve this problem.

### 7.1.3. Option 2: Extended revision

A generalised extension of Article 69 would give MS much greater flexibility to address problems in specific sectors, as well as risk issues, but it would imply several risks for the consistency of the CAP orientation.

Most measures currently applied by MS under Article 69 are production-linked, and this option would mean a backtracking from further decoupling as it would not limit the share of coupled measures under a revised Article 69. In the case of a DDA agreement, it would clearly risk exceeding the ceiling of Blue Box support (unless there was a corresponding parallel reduction in other partially coupled support).

**Figure 9: Actual and potential payments under Art. 69**



Source: DG AGRI calculation

Figure 9 gives an indication of the scale of a possible increase of the financial means for Article 69 by comparing the current funds used for

Article 69 in the MS applying it to the funds generated by a general 10% retention of the national ceilings.

## **7.2. Social impacts**

### *7.2.1. Option 0: Status Quo*

The constraints implied by the sector-specific rule of the current Article 69 could not only present income problems to certain producers but may also negatively affect the vitality of rural areas in regions where farmers have no viable alternatives.

### *7.2.2. Option 1: Targeted revision*

The targeted revision would give MS increased means to tackle possible income problems and support the continued vitality of rural areas, however with a limit on coupled support measures.

### *7.2.3. Option 2: Extended revision*

The extended revision would give MS increased means to tackle possible income problems and support the continued vitality of rural areas, without limiting coupled support measures.

## **7.3. Environmental impacts**

### *7.3.1. Option 0: Status Quo*

The constraints implied in the current Article 69 funding pose the risk that certain environmentally beneficial types of farming may be discontinued in particular areas.

As an example, the particular environmental benefits of rice cultivation (mainly with respect to water management) could be lost if this type of production was discontinued as a result of further decoupling.

### *7.3.2. Option 1: Targeted revision*

The targeted revision would give MS the possibility to provide support for the continuation of particular environmentally beneficial types of farming. However, there would be a limit on coupled support measures.

### *7.3.3. Option 2: Extended revision*

The targeted revision would give MS the possibility to provide support for the continuation of particular environmentally beneficial types of farming, without limiting coupled support measures.

## **7.4. Administrative impacts/simplification**

### *7.4.1. Option 0: Status Quo*

No impact.

#### 7.4.2. *Option 1: Targeted revision*

The targeted revision would demand some extra costs for the adjustment of the system but should not have fundamentally different costs of operation.

#### 7.4.3. *Option 2: Extended revision*

The extended revision would demand some extra costs for the adjustment of the system but should not have fundamentally different costs of operation.

## 8. CONCLUSIONS

With the experience gained so far with the implementation of the SPS system, the lack of a possibility for MS to adjust their chosen model towards a more flat rate of payment is an anachronism. Possibilities to make adjustments in the implemented models seem desirable as long as they respect the stated objectives of the system. The historic model of the SPS enabled the smooth transition to decoupling in MS whose variable production structures implied that various sectors were integrated successively into the SPS. The time seems ripe to allow MS to consider if they wish an adjustment towards a more flat rate.

But there are different ways of doing so and very different impacts from each way. While all options analysed fulfil the objective of leading to more equal rates per hectare or entitlement, none does actually result in any fundamental changes to the unequal distribution of support among farms. Flat rates at a larger scale (EU-wide or MS-wide under SAPS) have strong effects on land values with possible structural responses. The more targeted a move towards a regional flat rate is, the lower the impact on land values would be from the implied redistribution of support, and the more support would remain among active farmers. A gradual move towards flatter rates could contribute to making the adjustment process easier for farms.

With respect to environmental objectives the options have largely similar effects (apart from more negative elements of the SAPS). The same is true for administrative impacts where, after some obvious initial costs of adjustments to the system under all but the status quo, the operational costs should not differ substantially, although there may be some additional costs where there are new beneficiaries to the system. All SPS options can be combined with further simplifications to the system.

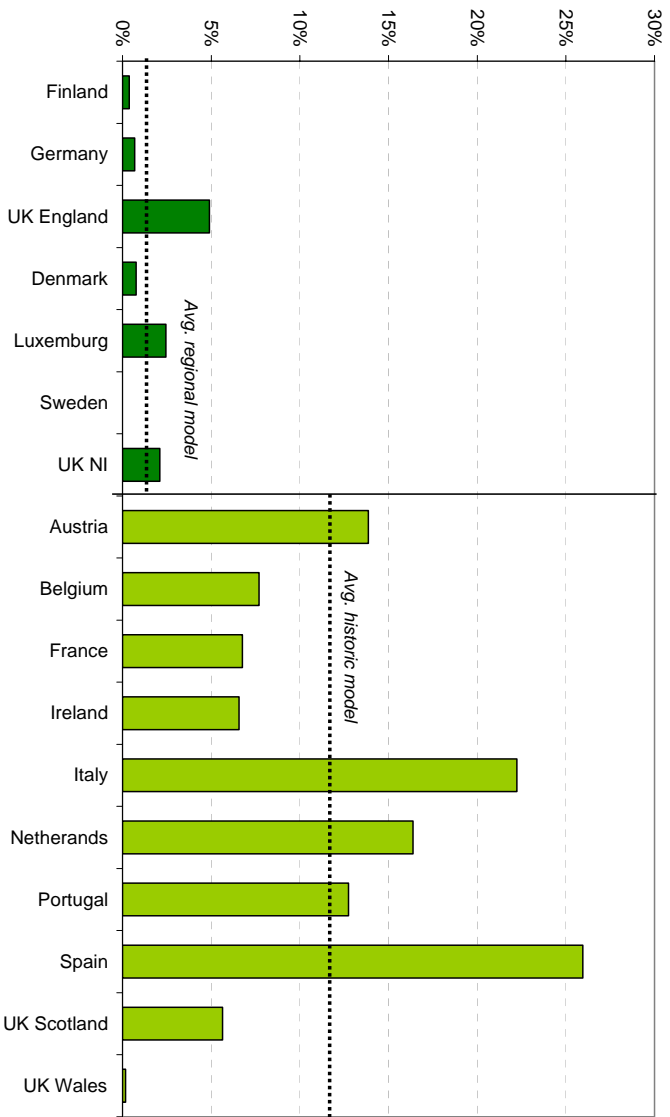
The best way to address potential problems in regions which could face a negative impact from the dairy quota phasing-out or further decoupling, or to deal with the potential need for additional policies addressing risk management seems to be through a revision of Article 69 that would allow part of the available level of SPS support to target such regions, provided that the global amount and the proportion of coupled support in the mix of supporting measures stayed within clearly defined ceilings.

This would allow supporting particular sectors and regions, mitigating negative effects on income, vitality of rural areas and environmentally beneficial farming practices while respecting WTO commitments.

# Annexes

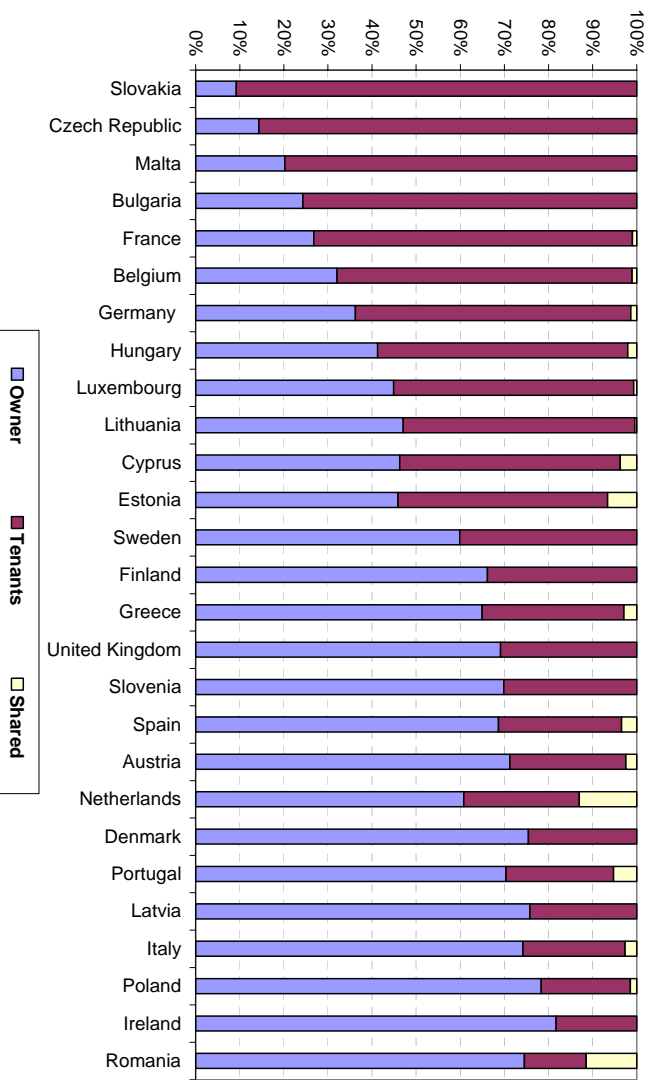
## Annex 1 - Graphs

Figure 1: "Naked land" in historic and regional/hybrid SPS models (2006)



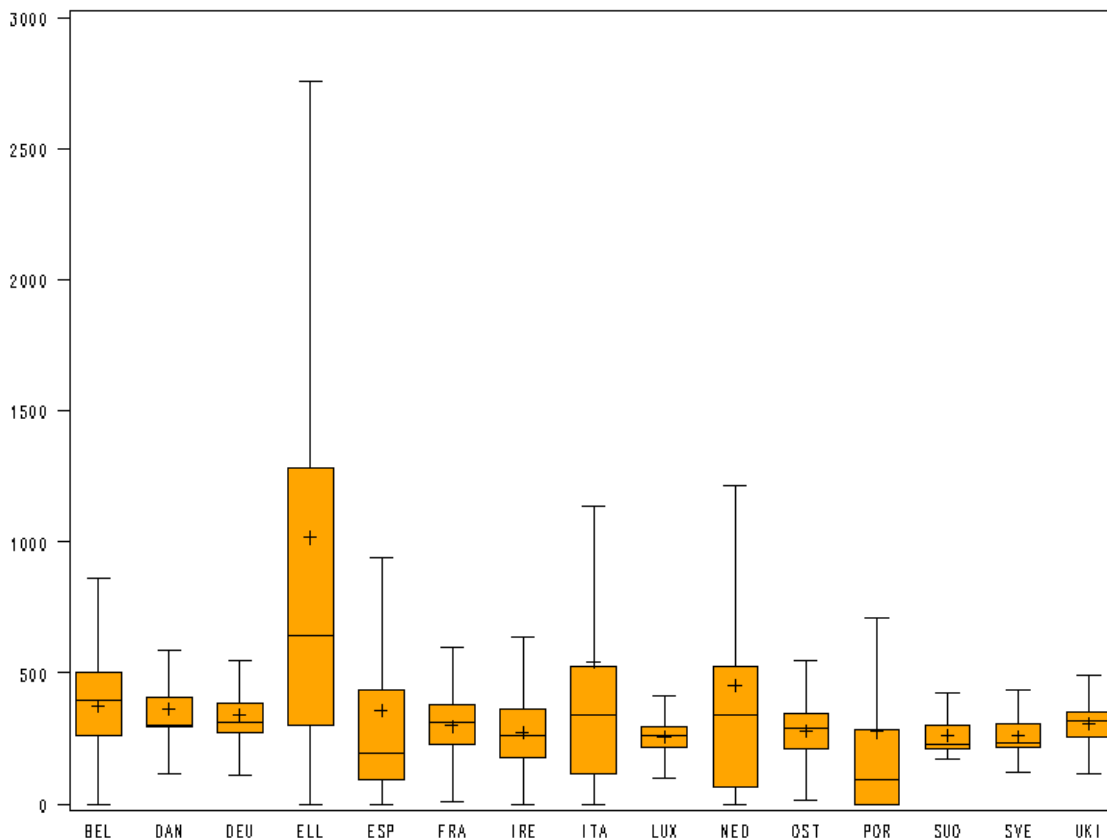
Source: DG Agriculture

Figure 2: The structure of ownership of EU farm land



Source: Eurostat.

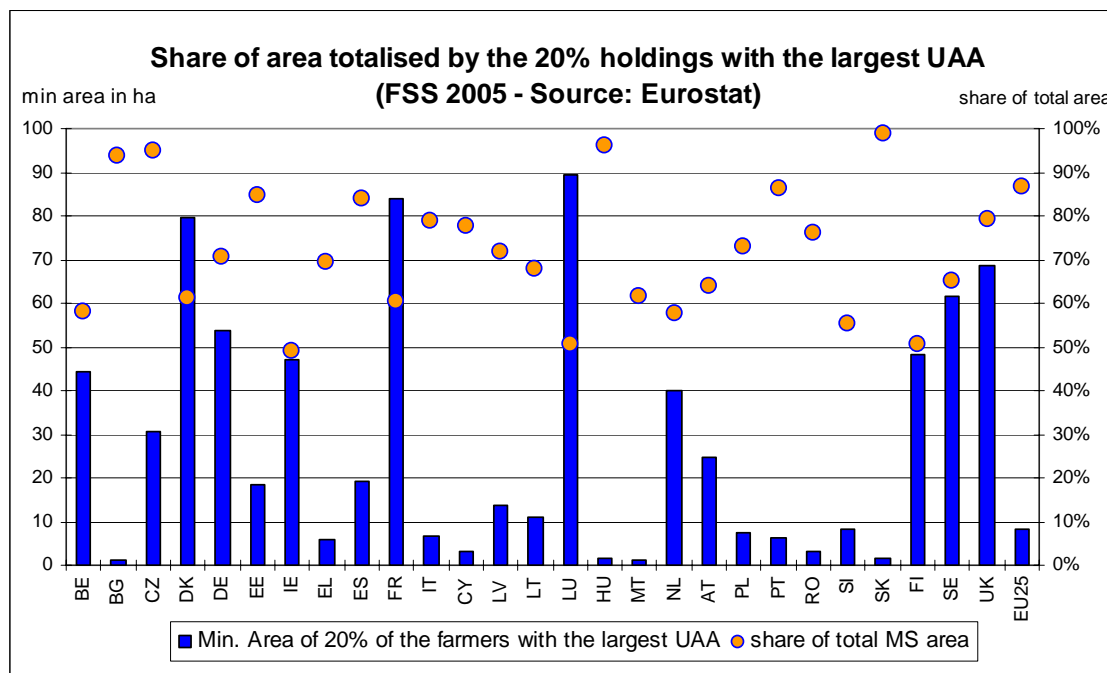
**Figure 3: Distribution of direct payments in €per hectare under historic and hybrid models (Status Quo)**



Source: DG AGRI EU FADN simulation

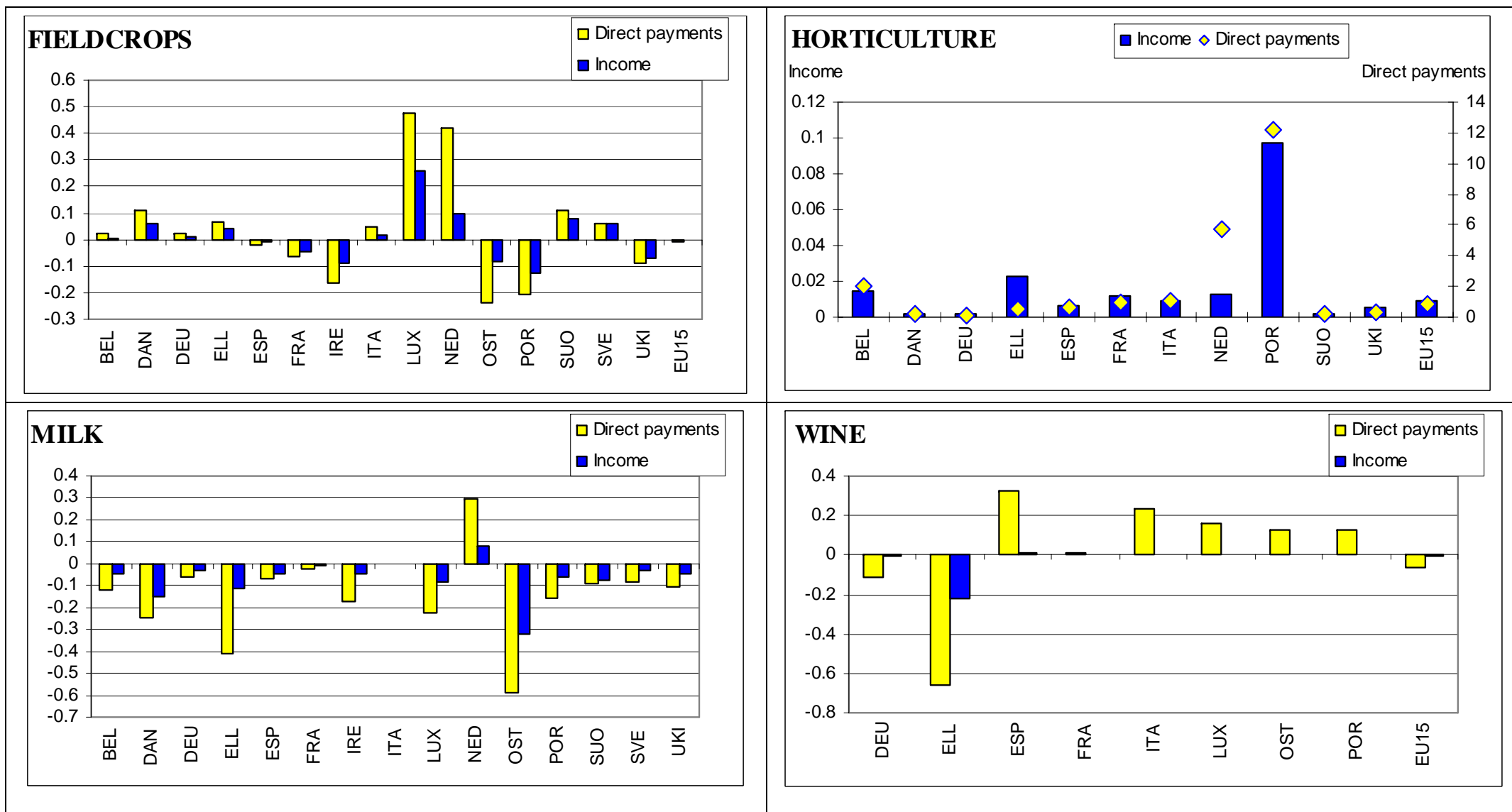
Note: Whiskers represent percentiles 5 and 95 / Box represents percentiles 25 and 75 / --- represents median / + represents mean / outliers are not represented

**Figure 4: Distribution of payments for EU wide flat rate on all UAA**



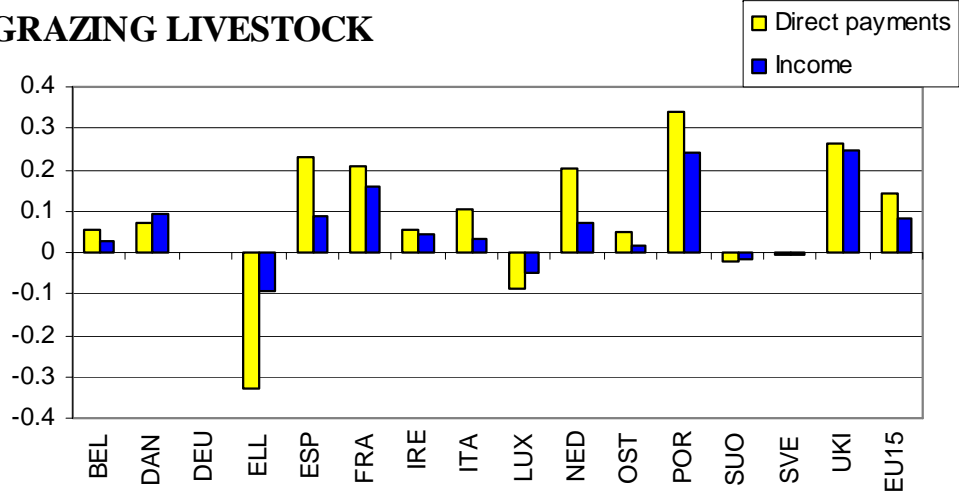
Source: Eurostat

**Figure 5: Impact of a regional flat rate by type of farming – EU15** *Source: DG AGRI EU FADN simulation*

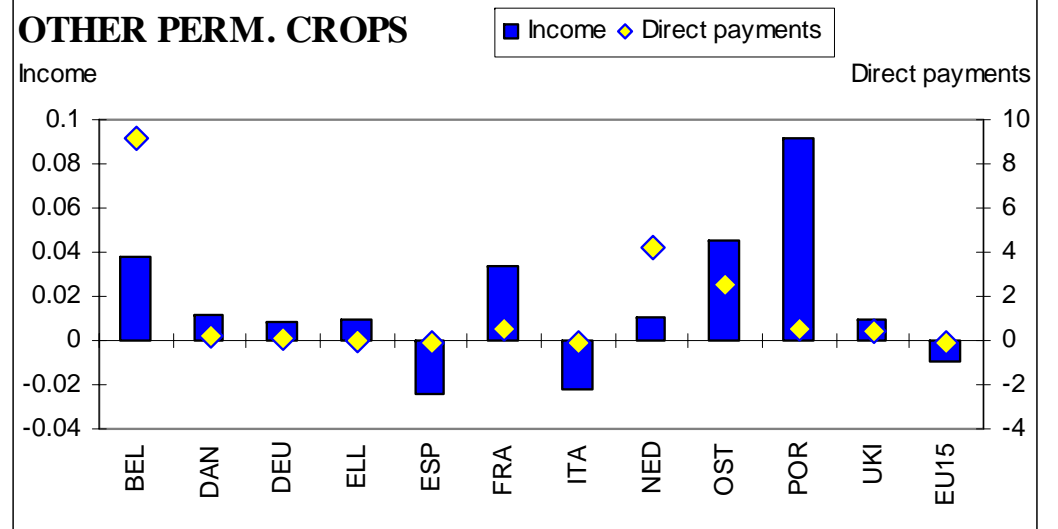




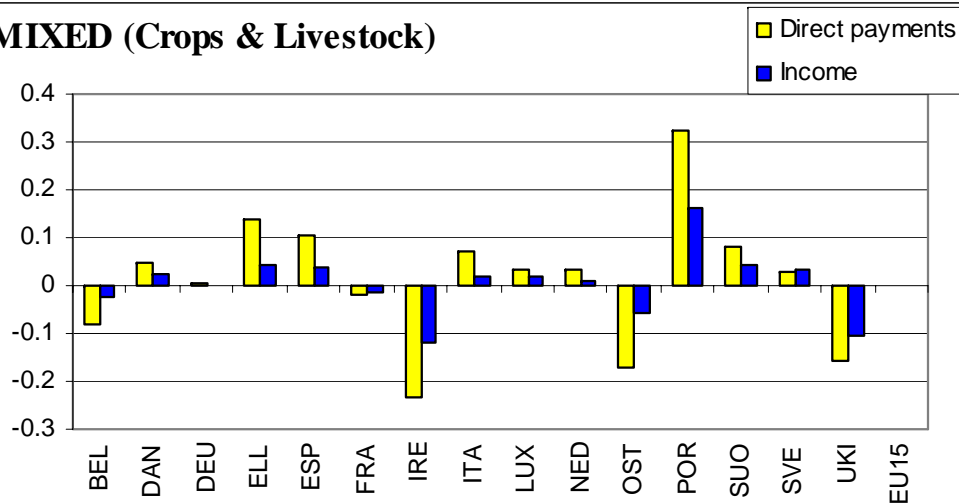
### GRAZING LIVESTOCK



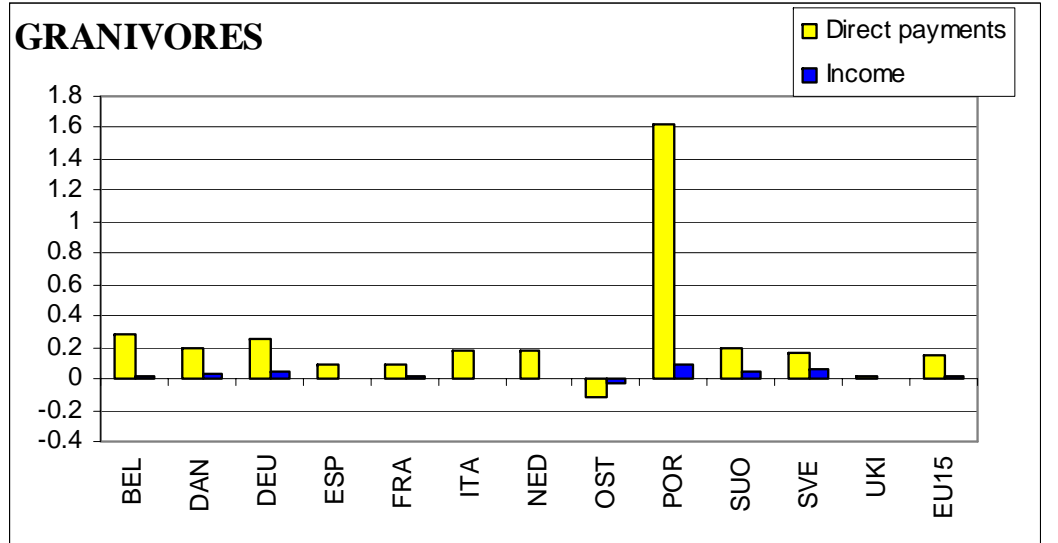
### OTHER PERM. CROPS



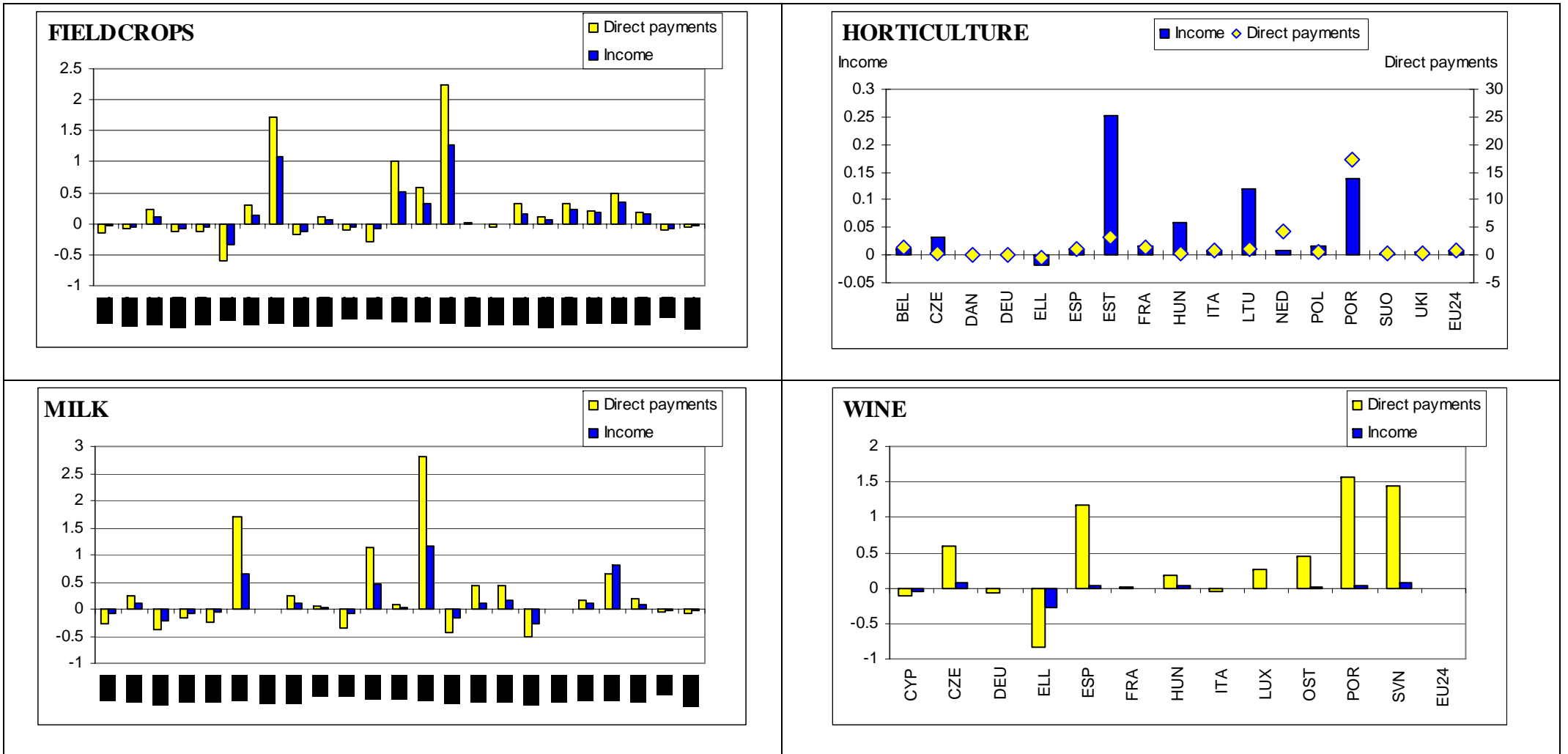
### MIXED (Crops & Livestock)



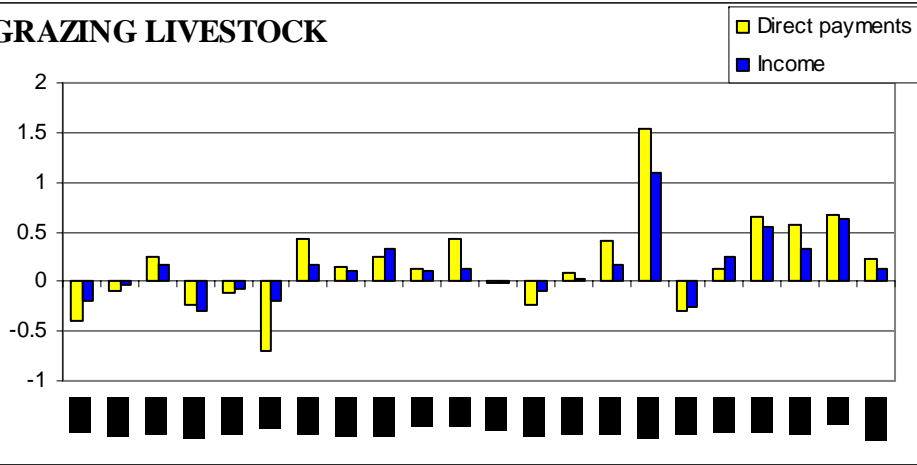
### GRANIVORES



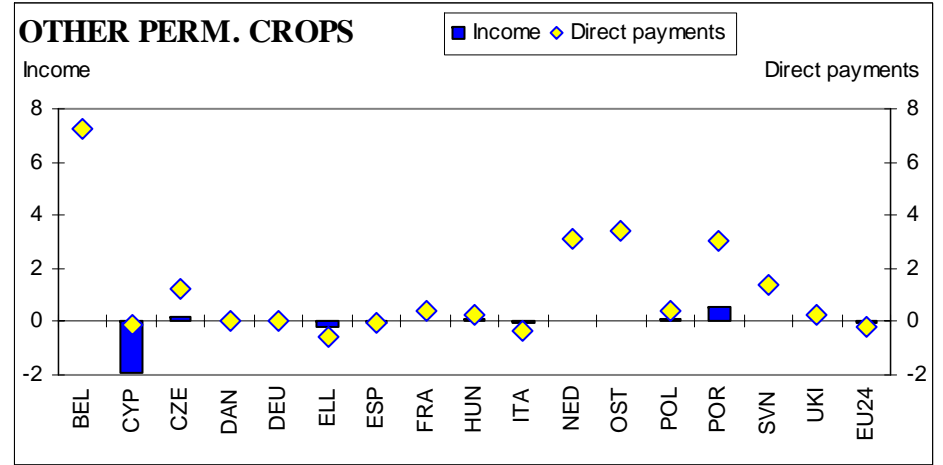
**Figure 6: Impact of a EU flat rate by type of farming – EU24** *Source: DG AGRI EU FADN simulation*



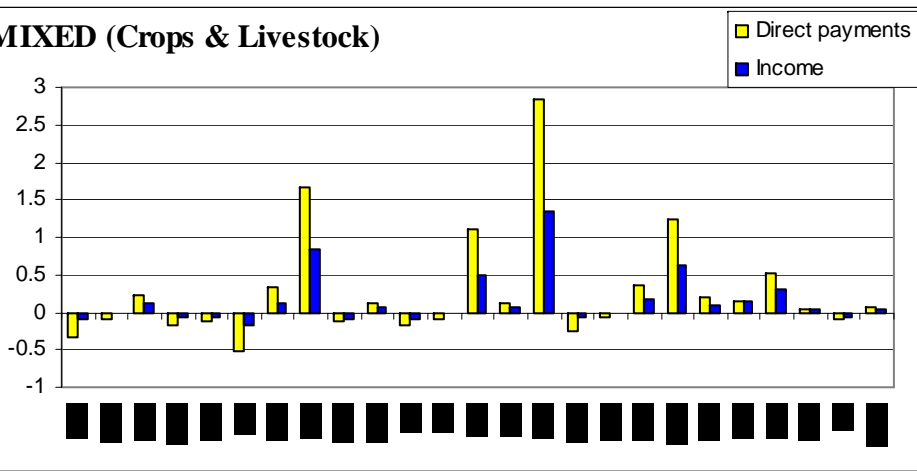
### GRAZING LIVESTOCK



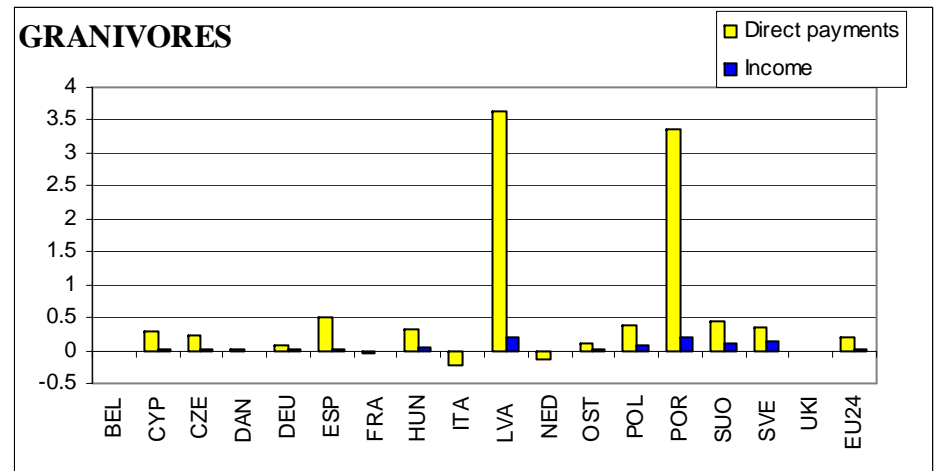
### OTHER PERM. CROPS



### MIXED (Crops & Livestock)



### GRANIVORES



## Annex 2 – FADN Simulations

### 1. Methodology

All simulations on microeconomic farm data are based on a model developed in DG AGRI - G3 (Aids4k). This model is based on the structure of the farms in 2004. The CAP is implemented as foreseen in 2009<sup>23</sup> including compulsory modulation<sup>24</sup> (except in the new Member States), the second package of reforms, the sugar and the fruit and vegetables reforms and 100% of SAPS in the new Member States. The wine reform is not covered.

Article 69 is not taken into account because of the difficulty to target the farmers eligible to these subsidies as decided by each MS.

For the historic model, the reference for each farmer is calculated based on its situation in FADN 2004.

For the hybrid/dynamic model:

- (1) The historic payments are calculated based on the farmer's situation in FADN 2004.
- (2) The grassland payment is 125 €/ha in Sweden and 67.11 €/ha in Denmark. In Germany the grassland payment is a regional flat rate calculated as the sum of 50% of the extensive premium, plus 100% of the adult slaughter premium and 100% of the national envelope for beef in a region divided by the permanent pasture represented in this FADN region.
- (3) The regional flat rate is calculated as the sum of the remaining envelope (all decoupled payments – historic payments – grassland payments) divided by the eligible hectares.
- (4) The direct payment (DP) received by a farmer in a region equals the sum of the coupled and re-coupled payments plus the historic part of the payment plus the grassland payment plus the flat rate in the region times the eligible area.

The eligible land is estimated in FADN for each individual farmer on the basis of the area registered by product in the farm return.

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<sup>23</sup> 2009 was chosen because in 2009 all the reforms are fully implemented (including fruit and vegetables and sugar). Moreover the options for the hybrid model are known for 2009. In all simulations, new MS are assumed receiving already 100% of the budget ceiling in 2009.

<sup>24</sup> Voluntary modulation is not taken into account.

## 2. The two simulated scenarios:

### (a) The regional flat rate

For the **regional model**, a "regional" flat rate per hectare is calculated as the sum of the decoupled payments in the region divided by the eligible area represented in this FADN region. This "regional" flat rate is calculated by FADN region, which may differ from the regions chosen by the MS. In England a "regional" amount is calculated for LFA and another one for non LFA. A farmer in a region receives the coupled and re-coupled payments plus the regional flat rate in this region times his eligible area.

### (b) The EU-27 flat rate

The **EU flat rate** is estimated as the sum of all the direct payments recorded in FADN (coupled and decoupled) in the EU24<sup>25</sup> divided by all the eligible area. The EU flat rate calculated by the model is 305 €/ha in the EU24. Limited to the EU15, its value would be 325 €/ha.

The two scenarios analysed can be summarised as follows:

	current model	Scenario 1: Regional flat rate	Scenario 2: EU flat rate
Year	2009	2009	2009
Coverage	EU 15 / EU 24	EU 15	EU 24
Coupled and re-coupled payments	Yes	Yes	No
Decoupled payments	Historic model (BE, FR, ES, EL, IT, NL, IE, PT, AT, Wales & Scotland) Hybrid / dynamic model (DA, DE, FI, SE, LU, England & Northern Ireland) Pure regional (SI) 100% SAPS (CZ, EE, CY, LV, LT, HU, PL, SK)	Regional model	EU-wide flat rate (EU15: 2009 budget EU9: 100% budget)

## 3. The impact indicator

The farm net value added (FNVA<sup>26</sup>) per annual working unit (AWU) is analysed as an income indicator, comparable between MS. For this analysis, the output was adjusted by the decrease in support prices foreseen in the milk and sugar reforms.

## 4. Other methodological assumptions

Other price changes that could occur in the following years in link to markets evolution are not taken into account.

<sup>25</sup> Malta is not covered in this analysis because 2004 data are not reliable.

<sup>26</sup> FNVA = output + direct payments – intermediate consumption – depreciation – taxes

In new MS, no top ups are added to the income because it is expected that at the time they will receive 100% of the payments they will stop the national subsidies.

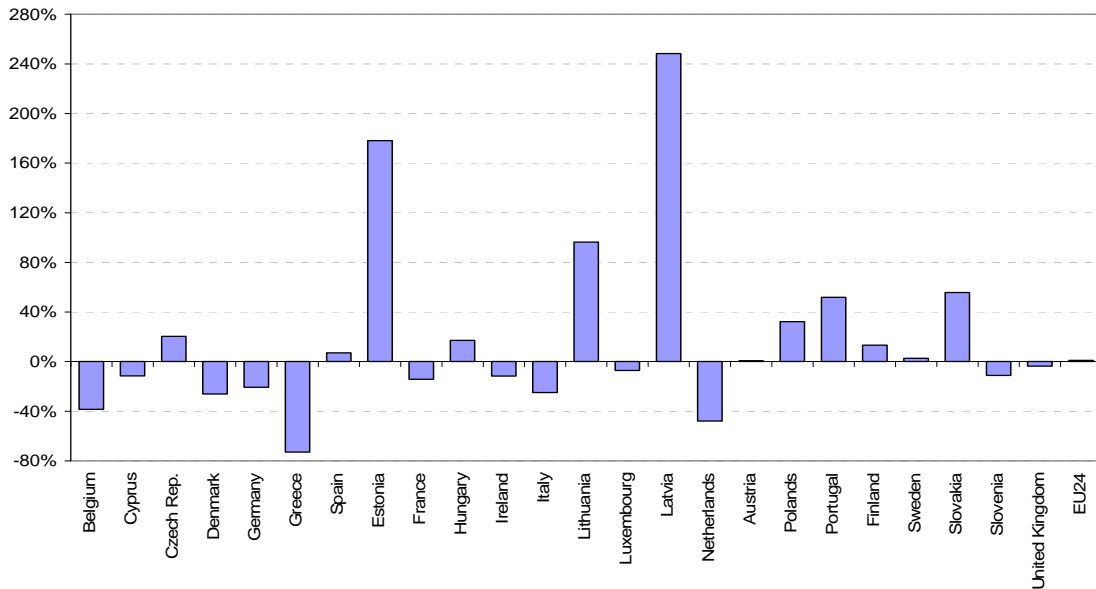
Since the regional amount is calculated with the FADN data that cover only "business" farms, the regional premium may be slightly overestimated because the FADN data includes a larger share of the direct payments than of the area.

Data are only displayed if they are based on at least 15 holdings in the FADN database.

### Annex 3: Distribution of direct payments between farms

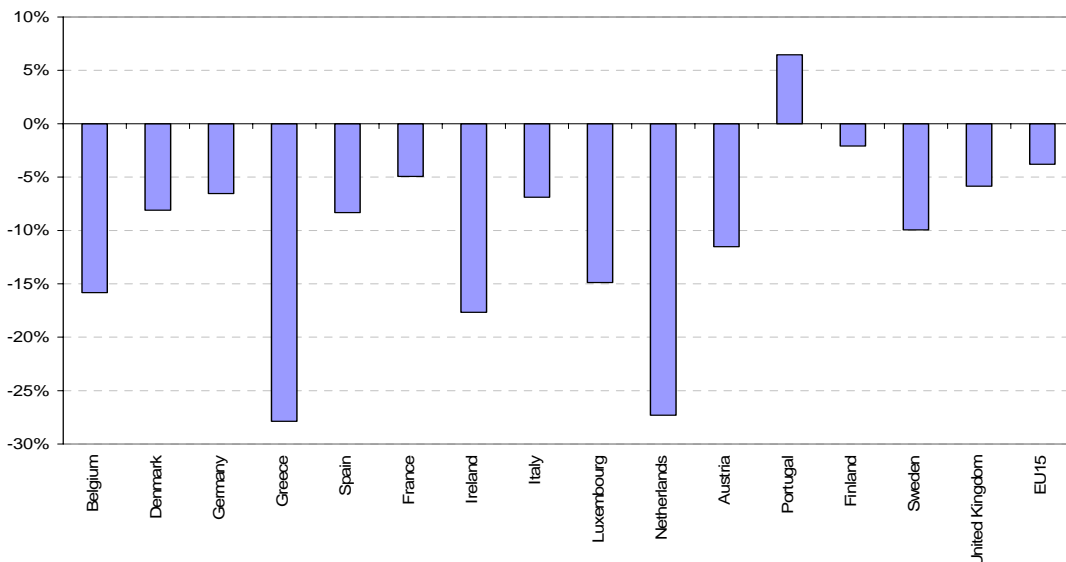
One measure of distribution is the **inter-quartile range**, the difference between the maximum DP received by 75% of the farmers and 25% of the farmers. FADN simulations show that both EU-wide flat rates and regional flat rates per eligible hectare do not lead to substantial changes in the range of direct payments overall. However, the change in the range of payments per farm varies strongly between MS (figures A and B).

**Figure A: Change in the range of payments per farm with EU flat rate (EU-24)**



Source: DG AGRI EU FADN simulation

**Figure B: Change in the range of payments per farm with regional flat rate (EU-15)**



Source: DG AGRI EU FADN simulation

Another method to measure the concentration of the direct payments per farm is to calculate the **Gini coefficient**. Under the Status Quo, the distribution of direct payments per farm in the EU-15 diverges from a uniform distribution line: the Gini coefficient is

0.680<sup>27</sup>. With a *regional flat rate* per eligible hectare the Gini coefficient is decreasing but in a rather limited proportion to 0.663.

When assessed by MS, the effects are more important. For a majority of MS, the Gini coefficient is decreasing, i.e. the distribution is closer to the uniform distribution line (in particular in Ireland, Portugal and the Netherlands). But in the UK, the Gini coefficient is increasing, moving to a higher concentration of the DP per beneficiary (see Table A).

**Table A: Concentration of direct payments per farm as measured by the Gini coefficient**

	Regional flat rate			EU flat rate		
	Current	Value	Change	Current	Value	Change
BEL	47.9	44.8	-3.1	47.9	42.8	-5.1
DAN	52.2	49.9	-2.2	52.2	49.5	-2.7
DEU	58.2	56.4	-1.8	58.2	56.5	-1.8
ELL	56.7	52.1	-4.6	56.7	50.7	-6.0
ESP	67.6	67.7	0.1	67.6	69.8	2.2
FRA	49.9	47.4	-2.5	49.9	45.7	-4.3
IRE	48.5	38.4	-10.0	48.5	38.4	-10.0
ITA	73.7	69.3	-4.4	73.7	68.1	-5.6
LUX	40.1	35.6	-4.5	40.1	35.6	-4.5
NED	59.6	51.1	-8.6	59.6	50.1	-9.5
OST	40.8	36.8	-4.0	40.8	38.4	-2.4
POR	82.1	71.2	-10.9	82.1	75.6	-6.4
SUO	36.3	36.2	-0.2	36.3	34.8	-1.5
SVE	45.3	44.8	-0.5	45.3	44.1	-1.2
UK	48.1	52.1	4.0	48.1	53.5	5.4
<b>EU-15</b>	<b>68.0</b>	<b>66.3</b>	<b>-1.7</b>	<b>68.0</b>	<b>68.4</b>	<b>0.4</b>
CYP	n/a	n/a	n/a	73.1	73.6	0.5
CZE	n/a	n/a	n/a	81.6	80.4	-1.2
EST	n/a	n/a	n/a	64.1	61.6	-2.6
HUN	n/a	n/a	n/a	78.3	77	-1.3
LTU	n/a	n/a	n/a	54	52.2	-1.8
LVA	n/a	n/a	n/a	59.6	54.9	-4.7
POL	n/a	n/a	n/a	48	46.4	-1.6
SVK	n/a	n/a	n/a	69.1	68.3	-0.9
SVN	n/a	n/a	n/a	50.3	39.7	-10.6
<b>EU-24</b>				<b>70.1</b>	<b>69</b>	<b>-1.1</b>

Source: DG AGRI EU FADN Model Aids4K

With an *EU flat rate*, the change in the Gini coefficient in the EU-24 is very small (from 0.701 to 0.690). For the EU-15, the concentration of the DP per farm is even slightly increasing with an EU flat rate.

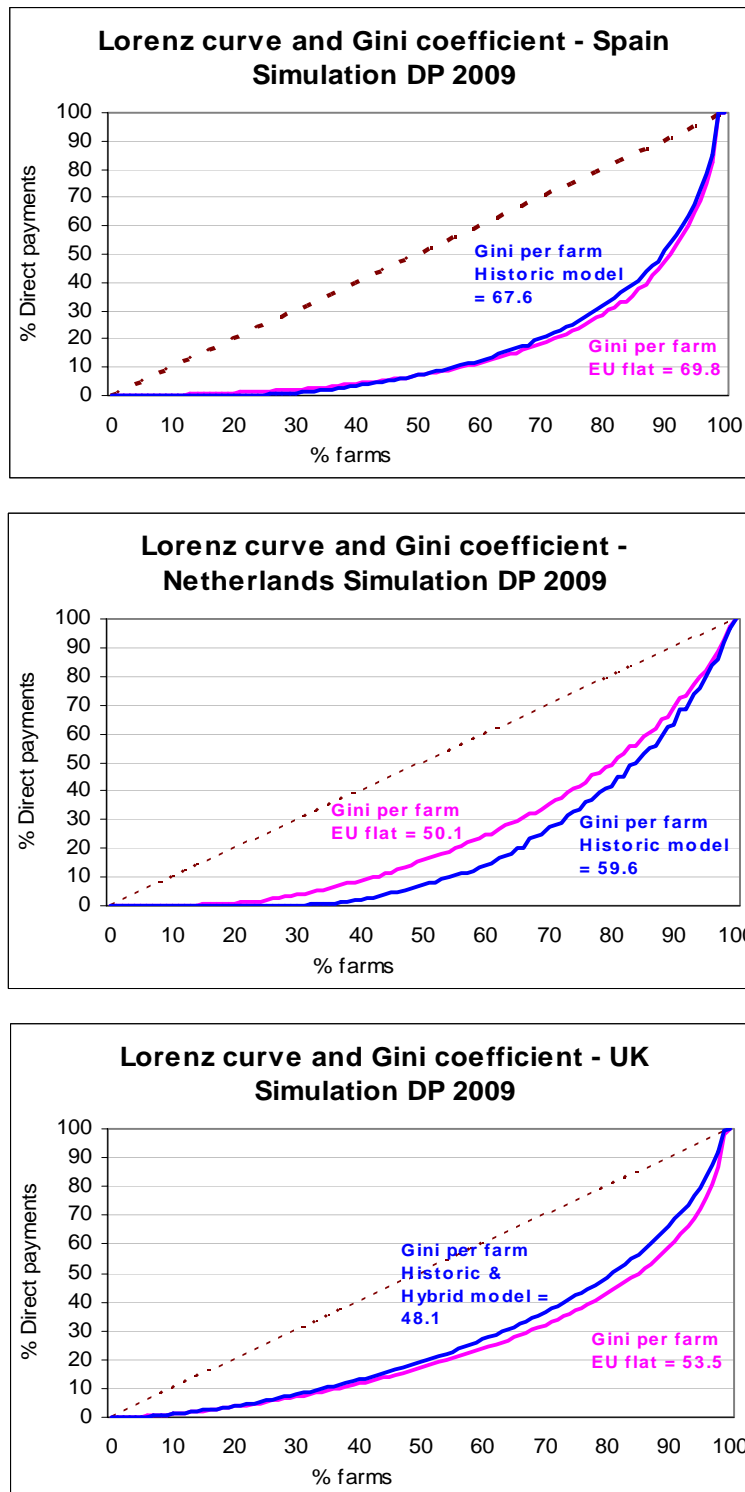
At the MS level, on the other hand, the effects are more contrasted: for a majority of MS, the Gini coefficient is decreasing, i.e. the distribution is closer to the uniform distribution line (in particular in Slovenia, Ireland and the Netherlands). But in the UK, in Spain and in Cyprus, the Gini coefficient is increasing moving to a higher concentration of the DP

<sup>27</sup> The Gini coefficient value is always between 0 and 1. A Gini coefficient at 0 means that the distribution of the DP is uniform (e.g. 50% of the DP are received by 50% of the beneficiaries). The Gini coefficient is moving to 1 with the increase of the DP concentration.



per farm (see Table A and see Figure C for Lorenz curve and Gini coefficient for selected MS).

**Figure C: Lorenz curve and Gini coefficient with Status Quo and EU-wide flat rate – Spain, the Netherlands and UK**



Source: DG AGRI EU FADN Model Aids4K